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PD-AAD-018-B1

DEPARTMENT OF STATE
AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

PROJECT ASSISTANCE PAPER

AFGHANISTAN: AGRICULTURAL CREDIT

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II. PROJECT BACKGROUND AND DETAILED DESCRIPTION

A. Background

Afghanistan's economy is based primarily on subsistence agriculture, involving about 85 percent of the population. The agriculture sector produces half of the gross domestic product and employs about 3.3 million people or 67 percent of the estimated active labor force. The rural population is largely engaged in agriculture and rural settlements are small and scattered throughout the country. Agricultural production is severely limited by climate and topography. Less than 7 percent of the land area (63 million hectares) is cultivated in any year and only half of this is irrigated. Wheat is the most important crop and is grown in over 60 percent of the cultivated area. Productivity, however, is low, averaging about 1.5 ton per hectare for irrigated wheat. As a result, farm incomes are also low, rarely greater than \$100 per capita on irrigated farms of 1.5 to 3.0 hectares. Approximately 25 percent of the rural population is below the absolute poverty level of \$53 per capita and the average farm size is about 3.5 hectares of cultivable land.

Economic growth during the past ten years has been modest and just matching the population growth. The three 5-year plans (1957-1972) focused on infrastructure projects which had only marginal impact on the incomes and well-being of the majority of the people. At this time there is an urgent need to move towards projects which increase agricultural production and will have a direct effect on the living standards of the rural poor. The major constraints to increasing agricultural production are inefficient extension services, inadequate supply of agricultural inputs and limited availability of credit.

AID, IBRD and other donors are attempting to alleviate these constraints through various agricultural development projects. One of IBRD's projects is financial and technical assistance to the Agricultural Development Bank of Afghanistan (ADB). This project was initiated in 1964 during discussions with the United Nations Food and Agriculture Office. At that time the Government of Afghanistan expressed a strong interest in financial assistance to the ADB then known as the Agricultural and Cottage Industries Bank. The Government submitted a formal loan request to the IBRD in 1967 and the Bank responded by sending a team to analyze the ADB's operations later that year. The team recommended a complete reorganization of ADB, including technical assistance prior to providing an IDA loan. The United Nations

Development Program agreed to finance a three-year technical assistance program with IBRD serving as the implementing agency. In 1969 a four-man consultant team was engaged to assume managerial and staff training activities for reorganizing ADB. The ADB was appraised in November 1969 by an IDA team which subsequently approved a \$5 million loan in June 1970. Upon the successful completion of the first loan, another loan for \$13 million was approved in March 1975, and now a third agricultural credit is being considered by IDA.

AID's interest in this project developed as a result of a combination of factors: (1) an agricultural assessment indicating that adequate agricultural credit is not readily available to the small farmer; (2) AID's desire to broaden its assistance in the agriculture sector; (3) to support AID's proposed Wheat Development Project and complement the Afghan Fertilizer Company, and (4) IUA budget constraints prevent it from developing the project as originally conceived. Consequently, AID suggested and IBRD/IDA agreed that AID, through its own project, would consider providing \$5 million in the form of a grant to the ADB for financing agricultural input loans to small-scale farmers.

B. Project Description

Historically, the small-scale farmer has not fully participated in Afghanistan's developing agricultural sector. This situation still continues today and results partially from a paucity of available agricultural inputs such as credit and extension services. Many farmers work their small parcels of land without the benefit of modern farming methods or short-term credit. As a result, farming practices remain unchanged, yields per acre are constant or even decrease and the small-scale farmer produces at a minimal substance level. Some farmers, however, have received assistance from the government extension services along with agricultural loans from the ADB. These farmers have realized increases in agricultural productivity and are producing and selling crop surpluses. ADB's experience has shown that farmers are receptive to new farming practices and interested in borrowing funds to purchase agricultural inputs, particularly fertilizer. The ADB, however, has not been able to meet the demand for agricultural loans. Consequently, lending to small-scale farmers may not increase unless the Bank receives additional funds.

The project has been developed in concert with the third IBRD/IDA loan to the government of Afghanistan in the amount of \$12,000,000 and a Canadian International Development Association (CIDA) loan in the amount of \$4,730,000. Proceeds from loans are to be on-lent to the Agricultural Development Bank of Afghanistan (ADB) for its agricultural lending operations, supporting services, technical assistance and for preparing a study of the fertilizer industry. The details relating to the IDA credit are contained in Annex C. The IDA credit including its integrated CIDA component was negotiated with the GOA and was duly ratified on May 10, 1977. The IDA loan committee has recommended approval and formal action by IBRD/IDA is expected shortly. The project, as developed, anticipates a \$5.0 million participation by USAID in the form of a grant to GOA which would lend the full amount to the ADB for use in making short-term seasonal crop production loans (fertilizers and seeds) to the operators of small farms. In addition, the IDA loan provides U.S. \$1,756,000 and the CIDA loan provides \$690,000 for these seasonal crop production loans. The total allocation for these seasonal loans would be \$7,446,000 including the \$5.0 million USAID grant. A key condition with respect to the effectiveness of the IDA loan is the approval of the USAID \$5.0 million grant for fertilizer and seasonal crop production inputs.

The GOA proposes to loan to ADB the funds that are provided under the IDA/CIDA loans and the USAID grant. The terms of the loan would provide for a 15-year loan with a five year grace period and interest at the rate of 4.5 percent per annum during the grace and amortization periods. ADB would be reimbursed for 70 percent of the incremental value of its seasonal crop production loans with the base period to be the year from September 1, 1976, through August 31, 1977, which encompasses the 1976 fall planting season and the 1977 spring planting season. / Accurate computation of the base period will not be possible until after August 31, 1977. However, present indications are that the base will be approximately Afs 600,000,000. From September 1, 1977 to August 31, 1978 ADB would finance from its own sources an amount equal to the base period sum plus 30 percent of the incremental amount. It would be reimbursed for the 70 percent of these incremental loans with IDA and CIDA together handling 23 percent and USAID financing the remaining 47 percent. Reimbursement of incremental loans (or possibly the final accounting if advances should be required) would not

take place until after the completion of the fall and spring cropping seasons of the lending year ending August 31, 1978. Subsequent reimbursements would be made on an annual basis thereafter until the full grant is utilized or until the terminal disbursement date of the grant, whichever date comes first.

Principal sums received in payment from former borrowers in excess of amounts required to amortize the GOA-USAID grant source loan would be utilized for the same type of seasonal crop production loans to the operators of small farms as were serviced during the USAID reimbursement (drawdown) period for a minimum of two years following the last reimbursement. Interest collected from borrowers shall not be tied and may be utilized by ADB to service its interest payments to GOA, for operating expenses, to augment its loan funds and for any other purpose consistent with its charter.

The ADB will be the implementing agency and will be responsible for carrying out the project activities. The ADB will utilize the fertilizer and pesticide procurement and distribution services of the Afghan Fertilizer Company (AFC), its fully owned subsidiary company to procure and distribute ADB-financed fertilizer to borrowers. Improved seeds will be available from the newly organized Afghan Seed Company which is responsible for seed multiplication and distribution.

Fertilizer and improved seeds are essential production inputs without which the operators of small Afghan crop farms cannot hope to increase their production and incomes. Since commercial fertilizer application does not exceed ten percent of the irrigable land area in Afghanistan, there is great potential for increasing fertilizer use and crop production if farmers can obtain agricultural credit. This project is based on the concept of providing small farmers with adequate seasonal production credit that will result in incremental fertilizer use when compared with the 1976/77 base year. Since USAID funds (\$5.0 million - Afs 250,000,000 @ Afs 50 per dollar) will be utilized to reimburse incremental use of fertilizer and seasonal production inputs, production of wheat will be increased significantly in absolute amounts but only slightly compared to total wheat production. It is assumed that GOA price policies will include adequate incentives for small farmers to increase production. Based on the ADB's past lending record for fertilizer and improved seed which has

provided average small farmer loans of about Afs 10,000 (\$200). USAID's Afs 250,000,000 grant would provide ADB with sufficient loan funds for about 25,000 small farmers to fertilize 50,000 hectares or 250,000 jeribs of crops which would not be fertilized otherwise. The maximum seasonal loan period is for one year so the USAID funds are expected to revolve several times before the five year grace period expires and amortization of the GOA loan to ADB begins. Funds generated from ADB profits and principal sums still available to ADB during the amortization period will continue to revolve and be utilized for production credit to small farmers.

C. Prior AID Experience

Several years ago AID was involved in agricultural credit in Afghanistan in an association with the Helmand-Arghandab Agricultural Finance Agency. AID experienced modest success in providing farm inputs and extending credit to farmers who were working small plots of land in the Helmand Valley. When AID's assistance was completed, the finance agency became a subsidiary (1970) of and subsequently incorporated with ADB on March 21, 1973. Under ADB's management most of the small farmer loans were collected and the credit program expanded to include mid- and long-term loans.

AID's world-wide agricultural credit experience is considerably more extensive, with exposure to many of the frustrations common in assisting third world countries in developing their agricultural sectors. One of the features of AID's agricultural credit programs has been the extent of their attention to small farmers. Of 42 AID country programs, 35 have concentrated on the small farmer. This applies to programs in Taiwan and South Korea where all the farms are small, so that no special small farmer emphasis was required; but the figure also includes 16 of the 18 programs in Latin America where wide disparities in farm size are usual. This small farmer bias does not necessarily extend to the very poorest farmers or to landless farm workers, but refers to viable small producers. It is important to note that our lessons of experience indicate that extending credit only to poor farmers will not guarantee success. Other necessary ingredients must accompany credit if we expect increases in food production followed by an improvement in farmers' incomes.

Some of the prerequisites to a successful agricultural credit program are: farmers possessing viable and economic plots of land; adequate irrigation; markets for crops; available transportation and reasonable network of roads; agricultural extension services; and finally farmers' desire and ability to change from traditional farming practices to modern methods which encourage using improved seeds and fertilizer. Evidence suggests that all of the above requirements are present in varying degrees in many areas of Afghanistan. Furthermore, small-scale farmers who inhabit these areas have the incentive and farming knowledge to increase crop yields if credit is available to purchase critical agricultural inputs.

D. Other Donor Involvement

The IBRD and UNDP are the only donors presently assisting the ADB. This is IBRD/IDA's third credit to ADB. Initial assistance was made available to ADB in December 1970 for \$5 million followed by a second credit in July 1975 for \$13 million. Another important donor is UNDP, which provides advisors to the ADB and will probably continue this arrangement during the implementation of the proposed project. The IBRD also is assisting with the expansion of the country's three vocational agriculture schools and developing four new schools for agricultural instruction. These schools train most of the agricultural extension agents. The IBRD is involved in the fertilizer distribution in Afghanistan and has financed the construction of 24 regional fertilizer warehouses for the Afghan Fertilizer Company. Additional IBRD/IDA agricultural sector projects are the Khanabad Irrigation Project and two credits for the Livestock Development Project. Other important donors involved in this sector are the French Technical Assistance Mission, which is active in research and extension services for cotton, and the Asian Development Bank which has provided a \$14 million loan to assist in financing the development of the Afghan Seed Company.

III. AGRICULTURAL AND RURAL DEVELOPMENT OBJECTIVES AND GOALS

The Government of Afghanistan's basic development objectives are:

- a. To increase agricultural production, particularly wheat and other food grains to realize self-sufficiency in food and conserve foreign exchange. The GOA will attempt to increase wheat production from 2.85 million tons in 1976 to 3.5 million tons by 1983.
- b. Increase agricultural productivity and farmers' income by providing credit facilities for farm inputs and agricultural investments.
- c. Improve rural families' standard of living and establish a more equitable adjustment in income distribution.

These objectives are reasonable given the size of the rural population. The Government is fully committed to actively pursue rapid social and economic development in rural areas in order to raise farm families' living standards and increase food production. Since the vast majority of people live in rural areas, it is not surprising that the Government has focused on agricultural and rural development.

Obtaining these objectives may, however, be difficult without foreign donor assistance. The overall poverty of Afghanistan coupled with the low levels of public and private sector savings limits the accomplishments that a Government development plan can achieve by utilizing only domestic revenues.

IV. THE AGRICULTURAL SECTOR

The further development of the agricultural sector is necessary if living conditions are to improve for the majority of the rural population. Agriculture accounts for 50 percent of GDP and is clearly one of the most important sectors in the economy. Besides providing virtually all of the food requirements for the rural population, domestic agricultural production also supplies most of the food for the urban population.

The main activities of this sector are wheat growing and animal husbandry. Foodgrain production uses approximately 90 percent of the total cultivable land area, with wheat acreage utilizing about 60 percent of the total. Cash crops such as cotton, sugar beets, fruits and nuts serve as important foreign exchange earners and account for an estimated 45 percent of total export earnings. Livestock, mainly sheep, contributes to export earnings and provides raw materials for the local handicraft industry. The growth in this sector has been modest over the past years, partially due to the limited utilization of modern agricultural inputs. The use of fertilizers, improved seeds, pesticides and farm equipment have not been employed to the fullest extent possible. Consequently, there is considerable potential for increased agricultural productivity through a greater utilization of agricultural inputs and farmer education programs.

Over the years, the major portion of development expenditures has been directed to infrastructural projects such as power, transportation and irrigation. Some of this development has focused on the agricultural sector to provide feeder roads, small irrigation systems, water drainage canals, distribution of fertilizer and other modern inputs along with extension services. Although some capital intensive infrastructural projects were constructed to increase agricultural development, total crop production has been disappointing. This resulted mainly from limited coordination between Government agricultural agencies and farmers, coupled with a lack of available credit for agricultural inputs.

If this problem is to be alleviated, the Ministry of Agriculture and the ADB must receive financial assistance to provide modern agricultural inputs and to improve farming methods. These activities include the distribution of fertilizers, improved seeds and pesticides, increased extension services and the establishment of model and experimental farms. To date, the fertilizer distribution program has been the most successful and has made the greatest impact on agricultural production. Most of the fertilizer distributed to farmers is sold on credit provided by the ADB.

The ADB is the only source of reasonably priced credit for agriculture. In the absence of ADB credit facilities, farmers must turn to the local money bazaar for short-term loans at interest rates which are considerably higher than ADB's. Although finance charges are expensive, many farmers depend on the bazaar for agricultural credit.